MODERNIZING THE STATE’S LOCAL SALES TAX DISTRIBUTIONS

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The State redistributes some local sales tax revenue among the counties.

“The redistribution” is actually many redistributions stacked together.

The formulas could be simplified and modernized to use current data and be more transparent.

Any changes could reduce funding to some counties and increase funding to others.

There are policy options to minimize losses and gains among counties.
## REFRESHER: LOCAL SALES TAX LEVIES

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“THE DISTRIBUTION” IS ACTUALLY MANY DISTRIBUTIONS

The First 2%

Article 39
Grocery
All Other

Article 40
Grocery
All Other

Article 42
Grocery
All Other
Current practice has been created in many stages over the past several decades.

The General Assembly has layered new policy decisions on top of older ones.

The current model is not necessarily one that the body would create now if starting anew.

The formulas include various combinations of:

- **Per capita distributions:** These use current year county population estimates with the goal to push money to counties that do not have major sales activity.
THE STATE REDISTRIBUTES THE FIRST 2% USING MANY FORMULAS

Current formulas include…(cont’d):

- **Point of sale distributions**: These use current data with the goal of keeping some tax revenue where it is generated. For items shipped or delivered out of county, the “point of sale” is the “point of destination.”

- **Adjustment Factors**: Created in 1988 with the goal of minimizing the impact of switching from “point of destination” to “point of origination.” The State later repealed “point of origination” and reverted to original practice, but the Adjustment Factors were not repealed.

- **Point of sale grocery data**: Based on sales in FY 1997-98, which is the last year this data was collected. Retailers no longer report the county in which taxes are collected.
Current formulas include…(cont’d):

- **2015 redistribution:** Pushes money to 79 counties with a goal of increasing funds to counties that would have benefitted (as of 2015) if collections were distributed 50% per capita and 50% point of sale.

Outside of the formulas:

- **Medicaid County Hold Harmless:** Payments from the State General Fund to counties who are losing money due to the 2007 Medicaid swap. ($25m in FY 2010-11; $105 million in FY 2018-19)

- **Medicaid City Hold Harmless:** Payments that shift money from a county to its cities.
$291m distributed to locals from 2% tax collections:
- $190,000 in tax collected from sales in Caswell County
- $190,000 in tax collected from sales in Pamlico County

All figures today are rounded & totals may not add precisely.

<table>
<thead>
<tr>
<th>Source</th>
<th>Caswell County</th>
<th>Pamlico County</th>
</tr>
</thead>
<tbody>
<tr>
<td>Article 39 non-grocery</td>
<td>$68,000</td>
<td>$74,000</td>
</tr>
<tr>
<td>Article 40 non-grocery</td>
<td>$137,000</td>
<td>$80,000</td>
</tr>
<tr>
<td>Article 42 non-grocery</td>
<td>$34,000</td>
<td>$37,000</td>
</tr>
<tr>
<td>Grocery per capita</td>
<td>$32,000</td>
<td>$19,000</td>
</tr>
<tr>
<td>Grocery historical point of sale</td>
<td>$16,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>2015 Redistribution</td>
<td>$115,000</td>
<td>$34,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$400,000</strong></td>
<td><strong>$262,000</strong></td>
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SALES TAX MODERNIZATION: PRINCIPLES

- The formulas could be simplified and updated to use current data and be more transparent.
- Staff have developed the following options that use current distributions as a baseline and aim to minimize the impact on counties.
  - The current advantages and disadvantages written in Statute would continue to affect distributions.
- A new formula could simplify the formula and use current data in all calculations.
  - All sales tax on grocery food distributed on a per capita basis.
  - All other 2% proceeds use one formula relying on current data.
- Cities receive a share of their County’s revenue; this would continue.
As long as the overall pool of money is unchanged, any change in the formulas will result in increases and decreases in the individual county distributions.

The overall formula can be adjusted to minimize any negative impacts:
- Overall changes of less than $40 million are optimal – represents 1% of the distribution
- County shifts must be evaluated individually for negative impacts

As this transition occurs: evaluate options by measuring negative and positive impacts

Economic growth will help to offset any revenue losses

Additional funding could also offset revenue losses
To minimize negative impacts, it is helpful to recognize the 3 basic types of counties.

<table>
<thead>
<tr>
<th>Factors to Consider</th>
<th>Urban Counties</th>
<th>Counties with Tourism</th>
<th>Rural Counties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rates of Sales</td>
<td>Generally, higher sales volume</td>
<td>Higher sales during tourism season</td>
<td>Generally, lower sales volume</td>
</tr>
<tr>
<td>Most Beneficial Allocation Method</td>
<td>Point of Sales %</td>
<td>Point of Sales %</td>
<td>Per Capita %</td>
</tr>
<tr>
<td>New Method to Minimize Tax Revenue Losses</td>
<td>Use ad valorem % to allocate a portion of proceeds</td>
<td>Include a tourism adjustment</td>
<td>Allocate 3% on an “Equity Basis”</td>
</tr>
</tbody>
</table>
An ad valorem distribution allocates money based on property tax data.

- It spreads the money to the rural counties, but not as much as per capita.
- Ad valorem percentages act as a compromise for the majority of counties.
  - For most counties, using ad valorem data produces a distribution between per capita and point of sale percentages.
TOURISM ADJUSTMENT IMPACTS

<table>
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<th>Effect of Tourism Adjustment</th>
<th>Urban Counties</th>
<th>Counties with Tourism</th>
<th>Rural Counties</th>
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<tr>
<td>Slight positive Impact</td>
<td>Very Positive Impact</td>
<td>Minimal Change</td>
<td></td>
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- Allows counties that bring in higher-than-average sales to keep more on a point of sales basis.
- Allows other counties to receive more on a per capita basis.
- Tourism counties may see per capita sales increase as much as 500% during tourism season.
- A tourism adjustment that only takes effect for the months where tourism is higher allows the formula to provide the most positive impacts year-round.
The Equity Factor allocates a small percentage to each county and each city.

Has the effect of raising the floor, impacting the poorest counties first.

Equity Factors are based on the number of digits in a county’s population.

- This allows the Factors to be weighted with populations while ensuring that all counties share in the state’s economic growth.
- Allows the distribution to have a “raise the floor” effect while only using a very small percentage of the funds.
COMBINING NEW FORMULA ELEMENTS

- New formulas need to maintain the balance of the current distribution in order to minimize negative impacts.
- It is difficult to find balance using just Per Capita and Point of Sale percentages.
  - Using a combination of Ad Valorem, Point of Sale, and Per Capita percentages can help to maintain relative balance for all counties.
- Each element may give advantages to different counties, but when used together, balance can be maintained in a data-driven distribution.
- Any change will bring some degree of negative impacts and positive impacts.
  - If additional funding is used, the option to eliminate negative impacts is possible.
NEW FORMULA FOR CONSIDERATION

- Move to a 60/30/7/3 Model with a Tourism Adjustment
- Formula:
  - 60% Allocated on a Point of Sale Basis
  - 30% Allocated on a Per Capita Basis
  - 7% Allocated on an Ad Valorem Basis
  - 3% Allocated on an Equity Basis
- Counties with higher than average sales on a per capita basis can receive more money on a point of sale basis.
  - Example: Instead of 60/30/7/3, they could have up to 70/20/7/3.
The Counties are arranged with urban on the left and rural on the right. The 0% line is the current distribution.

This graph represents a sampling of the counties. Dollar amounts are higher for some and lower for others, but generally follow the same distribution pattern.
On both graphs, the 0% line is the current distribution. The dots show the change from current distribution.
NEW FORMULA IMPACTS

- Some counties will see negative impacts and some will see positive impacts
  - Total money moved for all counties and cities will be $37 million

- Most county changes are within -5% and +10%
  - Largest county loss is -6.2%
  - Largest county gain is over 21%

- Smaller counties gain a higher percentage, due to distributing 3% on an equity basis
- All calculations have been done using FY 18-19 data; totals have been rounded.
ONE ALTERNATIVE OPTION: ADDITIONAL FUNDS ADDED

- Method: Move to a 52/35/10/3 Model with Tourism Adjustment and Additional Funding
- Prior option designed without additional funds. With additional funds, every county and every city receives increased distributions.
- Formula:
  - 52% Allocated on a Point of Sale Basis
  - 35% Allocated on a Per Capita Basis
  - 10% Allocated on an Ad Valorem Basis
  - 3% Allocated on an Equity Basis
- Counties with higher than average sales on a per capita basis can receive more money on a point of sale basis.
  - Ex: Instead of 52/35/10/3, they could have up to 62/25/10/3.
- Adds a calculated 0.25% amount of sales tax to the distribution, which equals $361 Million in FY 18-19.
The Counties are arranged with urban on the left and rural on the right. The 0% line is the current distribution.

This graph represents a sampling of the counties. Dollar amounts are higher for all, but generally follow the same distribution pattern.
OPTION WITH ADDITIONAL FUNDS ADDED: IMPACTS

- Every County and City gets increased distributions
  - More than the current formula
  - More than a 75% point of Sale / 25% Per Capita formula
  - More than a 50% point of Sale / 50% Per Capita formula

- Most counties gain between 5% and 20%, lowest gain is 0.45%

- Smaller counties gain a higher percentage, due to distributing 3% on an equity basis
OTHER OPTIONS WITH LESS OPTIMAL, MIXED IMPACTS

- Infinite options available. Infinite “baselines” available for comparison.
- Options discussed in recent years:
  - 50% Point of Sale / 50% Per Capita
    - Mixed results, less optimal
    - Total money moved $49 million
    - One county loses over 30%
  - 75% Point of Sale / 25% Per Capita
    - Mixed results, least optimal outcomes
    - Total money moved $66 million
    - One county loses 30%
CHANGES COULD BE MADE TO OTHER ARTICLES AS WELL

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